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TRANSITION TO A SINGLE-CURRENCY SYSTEM

Report by the Director-General

Provides information on further developments, inter alia, resulting from the closure of the biennial accounts, as well as on the management of technical cooperation projects in both dollars and euros, in compliance with PBC conclusion 2003/6 and Board decision IDB.27/Dec.5.

Introduction

1. The Secretariat has kept the governing bodies regularly informed of the steps taken to introduce the euro as a single currency for budgeting, assessment, accounting and reporting, with effect from the fiscal period 2002-2003. Most recently, the General Conference at its tenth session had before it document IDB.27/9–PBC.19/9, as well as Industrial Development Board decision IDB.27/Dec.6.

2. Both the Programme and Budget Committee conclusion (2003/6) and Board decision (IDB.27/Dec.5) requested the Director-General to inform Member States of further developments, inter alia, resulting from the closure of the biennial accounts, as well as on the management of technical cooperation projects in both dollars and euros.

I. EXPERIENCE AND ACTION TAKEN

3. As stated in document IDB.26/4-PBC.18/5, the Secretariat expected the emergence of a clearer picture on the issues encountered and the actions required to rectify these during the preparation of the accounts for the biennium 2002-2003. The accounts for the biennium 2002-2003 showing the utilization of financial resources during the period 1 January 2002 to 31 December 2003 have been finalized. They provide information on the regular and operational budgets, as well as the technical cooperation activities financed from extrabudgetary resources, and information relevant to the single-currency system is contained in the following paragraphs.

Regular and operational budgets

4. The regular budget continued to have a certain amount of dollar expenditure during the biennium 2002-2003. As previously reported, this is unavoidable due to the fact that there are expenditure types that are either based on United States dollar scales and schedules (e.g. certain staff entitlements, or the Organization's contribution to the United Nations Joint Staff Pension Fund), or are being settled through the UNDP clearing account, which operates in United States dollars. The most significant expenditure type under the latter scenario relates to expenditures incurred in the field offices that use UNDP for their financial operations. Under those expenditure categories that did not follow the above pattern, the Secretariat made special efforts to reduce its exposure to non-euro commitments.

5. The exchange rate movements during the biennium were favourable in respect of the regular

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budget and hence a transfer to the reserve account could be made (see below).

6. The operational budget, on the other hand, has suffered from lower purchasing power due to exchange rate movements. The income of the operational budget is driven by technical cooperation expenditures, which were accounted for in United States dollars. However, the majority of expenditures in the operational budget continued to be in euros, leading to a loss of €1,173,000 during the biennium. Consequently, the operational budget reserve showed a slight deficit at the end of the biennium, despite the reported increase in technical cooperation delivery and the significant reductions in resource utilization when compared to the original budget estimates. In view of this, the Secretariat will explore the possibility of covering such losses.

Special account for regular budget exchange rate fluctuations

7. The General Conference authorized the creation of a reserve to protect the regular budget from the impact of exchange rate fluctuations in those expenditure categories that are by nature dollar-based (GC.8/Dec.16 (d)). These are the same expenditure types that in the past were budgeted in dollars and represented the dollar portion of the split-currency assessment.

8. The special account was created with a zero initial balance. At the closure of the biennium 2002-2003, as part of the preparation of the financial statements, the Secretariat determined the amount of funds that had to be placed on the special account due to favourable exchange rate movements during the full biennium.

9. In determining the exchange rate gains experienced during the biennium, the methodology previously reported and approved by the General Conference in its decision GC.8/Dec.16 was followed. The actual United States dollar expenditures on those specific dollar-based expenditure lines was determined and the difference between the exchange rate assumed at the time of the budget preparation and the actual rates experienced were used to determine the gain to be transferred to the special account.

10. The closing balance of the account has been reported in the financial statements as €1,840,776.

Management of technical cooperation activities in both dollars and euros

11. During 2003, the Financial Performance Control System was upgraded. Following the upgrade in 2003, the new feature to budget in multi-currencies became available. UNIDO has introduced the euro into its project management cycle making it possible for any project to be accounted for either in dollars or euros. Sources of funds for ongoing projects were reviewed to classify them as dollar-based or euro-based projects. Funding from UNDP, Global Environment Facility and Multilateral Fund for the Implementation of the Montreal Protocol would continue as dollar-based. Therefore, the corresponding projects remain on the dollar track. The basis of determining projects as euro-based would be the contribution currency, including the Regular Programme of Technical Cooperation, together with those projects where UNIDO is required to report in euros.

12. With respect to existing projects identified as euro-based, the fund balance available in United States dollars at the end of 2003 has been converted into euros, using the exchange rate of 31 December 2003. In order to re-establish the purchasing power of the projects with euro expenditures, options are being examined to allocate the required amounts from the accumulated but not yet distributed exchange gains on euro cash and investment balances.

13. During 2002-2003, all technical cooperation activities were administered in dollars, whereas the regular and operational budgets were managed in euros. To present the consolidated financial statements of UNIDO for the biennium ending 2003, the following actions were taken (details will be contained in the report of the External Auditor for the biennium 2002-2003,[1] which includes the notes to the financial statements):

- Combined statement of income and expenditure and changes in reserves and fund balances for the year ended 31 December 2003 (notes to the financial statements—annex II, table 1) has been prepared in both euros and dollars;
- Combined statement of assets, liabilities, and reserve and fund balances as at 31 December 2003 (notes to the financial statements—annex II, table 2) has been prepared in both euros and dollars;
- For the above statements, all non-euro items were converted to euros using the following approach:
  - The reserves and fund balances at the beginning of 2002, which were in dollars, were converted to euros at the exchange rate of US$1= €1.123 (GC.9/Dec.15);
  - Income, expenditure and changes in reserves and fund balances are stated in the equivalent amount of euros applicable as at the deemed

[1] To be issued to the Board at its twenty-ninth session through the Programme and Budget Committee.

date of the transaction, applying the United Nations operational rate of exchange as at that date, i.e. the applicable monthly exchange rate;

- Assets, liabilities, reserves and fund balances as at 31 December 2003 were revalued to euros using the United Nations operational rate of exchange as at 31 December 2003 (in accordance with decision GC.9/Dec.15).

- The loss arising from the revaluation of assets, liabilities, reserves and fund balances as at 31 December 2003 is shown as "other adjustments to reserves and fund balances" on the euro combined statement of income and expenditure and changes in reserves and fund balances (notes to the financial statements—annex II, table 1). These adjustments/revaluations have no implications as far as the donors are concerned, as the dollar statements provide the correct information about the status of funds provided by them, and the activities carried out from those resources. The donors, therefore, could disregard the euro statements.

14. The dollar presentation of technical cooperation activities required that the non-dollar monetary assets and liabilities be revalued as at 31 December 2003 using the United Nations operational rate of exchange. Any resultant unrealized gain is not recorded as income for the period, but set aside as an account payable until realized, for reasons of prudence.

15. The gain arising from the revaluation of euro cash and investment balance is also set aside as an account payable and not distributed to donors. In view of the stronger euro, the total amount set aside for 2002-2003 is $7.7 million. Such amounts will be used in 2004 principally to restore the purchasing power to projects with euro expenditures following the introduction of euro-based budgeting, after which any residue will be available for distribution.

16. At that stage donors who have funded activities in euros could disregard the dollar statements, as for these donors the euro statements would provide correct information about the status of funds provided by them and the activities carried out from those resources.

17. The governing bodies will be kept informed of further developments following the introduction of euro-based management of technical cooperation programmes, the restoration of purchasing power and the final closure of accounts for the biennium 2002-2003, as well as discussions with the External Auditor.

II. ACTION REQUIRED OF THE BOARD

18. The Industrial Development Board:

"(a) Takes note of the information provided in document IDB.28/9 on the transition to a single-currency system, in particular regarding the preparation of the accounts for the biennium 2002-2003;

"(b) Notes with satisfaction the steps taken by the Director-General to ensure the implementation of the euro;

"(c) Requests the Director-General to inform Member States of further developments related to the transition to a single-currency system, as well as on the management of technical cooperation projects in both dollars and euros;

"(d) ....."